
February 22, 2011

BUREAU OF LOCAL GOVERNMENT FINANCE OPINION

Ms. Salvacion T. Alcober
Finance and Accounting Manager
Logic Pacific, Inc.
Unit 1906-A, East Tower
Philippine Stock Exchange Center
Exchange Road, Ortigas Center
Pasig City

Madam :

This refers to your letter dated January 28, 2011 requesting opinion as to whether passive income, such as intercorporate dividends is exempted from local business tax.

It is represented that LOGIC PACIFIC, INC. (LPI), with principal office located at 1906A East Tower, PSE Centre, Exchange Road, Ortigas Center, Pasig City, is currently engaged in leasing real properties. That sometime in year 2008, that company invested in shares of stock with a domestic corporation. That during calendar year 2009, the company received its dividend income from the domestic corporation. The said dividend income received was reflected in the financial statement as Other Income.

Discussion:

1. Intercorporate Dividends are passive income, being one of those enumerated in Sec. 27 (D) of the Internal Revenue Code of 1997.
2. Sec. 27 (D) (4) of the National Internal Revenue Code of 1998, provides that "Intercorporate Dividends — Dividends received by a domestic corporation from another domestic corporation shall *not be subject to tax.*
3. The tax on business being imposed by the city is based on Gross Receipts which is defined in Sec. 131 (n) of the Local Government

Code, as follows:

"(n) *Gross Sales or Receipts* include the total amount of money or its equivalent representing the contract price, compensation or service fee, including the amount charged or materials supplied with the services and deposits or advance payments actually or constructively received during the taxable quarter for the services performed or to be performed for another person excluding discounts if determinable at the time of sales, sales return, excise tax, and value-added tax (VAT);"

4. The above definition of the phrase "gross sales or receipts" does not include nor make mention of passive income such as intercorporate dividends as part of "gross sales or receipts" and therefore such income is not subject to local business tax.

In this connection, attention is invited to Section 143 (f) of the Local Government Code (LGC) of 1991 quoted hereunder:

"Section 143. *Tax on Business.* — The municipality may impose taxes on the following businesses:

"xxx xxx xxx.

"(f) On banks and other financial institutions, at a rate not exceeding fifty percent (50%) of one percent (1%) on the gross receipts of the preceding calendar year derived from interest, commissions and discounts from lending activities, income from financial leasing, dividends, rentals on property and profit from exchange or sale of property, insurance premium.

It is clear from the aforequoted Section that unless imposed on banks and other financial institutions, any tax imposed on interest, dividends, and gains from sale of shares of non-bank and non-financial institutions assume the nature of income tax. The reason for this is evident: while banks and other financial institutions derive gross receipts in the ordinary course of their business as financial institutions, the same cannot be said for non-bank and non-financial institutions. As to the latter, interest, dividends, and gains from sale of shares are merely passive investment income.

Further, Section 131 (n) is quoted as follows:

"[Section 131(n), LGC] 'Gross Sales or Receipts include the total amount of money or its equivalent representing the contract price,

compensation or service fee, including the amount charged or materials supplied with the services and deposits or advance payments actually or constructively received during the taxable quarter for the services performed or to be performed for another person excluding discounts if determinable at the time of sales, sales return, excise tax, and value-added tax (VAT)."

The above definition of the phrase "gross sales or receipts" does not include nor make mention of passive income such as dividend income received from another domestic corporation, as one of those that are considered part or form part of the "gross sales or receipts" and therefore such income is not subject to local business tax.

Thus, income arising from interest, *dividends*, royalties do not form part of LPI's gross receipts as these are merely incidental having been earned outside of its primary scope of business operations and therefore not subject to local business taxes under Section 143 of the LGC.

We hope that this will help clarify matters.

Very truly yours,

**(SGD.) MA. PRESENTACION R.
MONTESA, CESO III**
Executive Director